

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE O.R. TAMBO DISTRICT MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying consolidated financial statements of the O.R. Tambo District Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2010, the consolidated and separate statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages ... to

Accounting Officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (GRAP) reporting framework and in the manner required by the Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa (Act No. 108 of 1996), read with section 4 of the Public Audit Act of South Africa (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Infrastructure assets, accumulated surplus and capital commitments

7. The correction of error amounting to R108 million disclosed in notes 10 and 34 to the financial statements, which relates to a prior period error, was not properly supported by appropriate documentation and numerous errors were identified during testing of this journal. This amount was recorded as a debit to infrastructure work in progress and a credit to accumulated surplus. Due to the nature of the errors identified, there were no alternative procedures that could be applied to verify this amount.
8. Consequently, I was not able to determine the possible impact of this on the opening accumulated surplus balance of R3.12 billion as disclosed in the consolidated statement of financial position.
9. Further, there was no system of control, on which I could rely, to ensure that all infrastructure assets were recorded, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all infrastructure assets and infrastructure work in progress was properly recorded.
10. Consequently, I did not obtain all the information I considered necessary to satisfy myself as to the valuation, existence and completeness of the infrastructure assets balance of R3.4 billion (2008/09: R3.2 billion) as disclosed in note 10 to the financial statements and the capital commitments balance relating to infrastructure of R729.1 million (2008/09: R749.4 million) as disclosed in note 37 to the financial statements.

Revenue

11. There was an inadequate system of control over service charges revenue on which I could rely for the purpose of my audit, and the entity's records did not permit the application of alternative audit procedures in order to obtain reasonable assurance that all service charges revenue was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of service charges revenue of R88.9 million (2008/09: R56.3 million) as disclosed in the statement of financial performance and note 18 to the financial statements.

Operating Expenditure

12. The municipal entity, Ntinga O.R. Tambo Development Agency, was unable to provide proof of delivery for goods or receipt of services and evidence of approval for operating expenses, relating to project and general expenditure, amounting to R50.3 million included in the total expenditure balance of R984.9 million as disclosed in the statement of financial performance. This limitation on the scope of my work was imposed by a fire which destroyed expenditure vouchers. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the goods and services were actually received by the entity and appropriately authorised. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence and compliance, including the possibility of irregular expenditure and fruitless wasteful expenditure incurred, for the group's operating expenses amounting to R50.3 million.

Water distribution losses

13. Water distribution losses amounting to R15 million (2008/09: R27.8 million) disclosed in note 44 to the financial statements were not supported by appropriate documentation and calculations. The municipality does not have adequate systems and controls to measure and monitor distribution losses. As a result, there were no alternative procedures that could be applied to verify this disclosure.

14. Consequently, I was unable to determine the accuracy, completeness and occurrence of the water distribution loss as disclosed in note 44 to the financial statements.

Leave pay provision

15. The municipality's prior year leave management process did not have an adequate basis for the management and recording of leave transactions as I was unable to agree the leave schedules provided to the manual leave forms. I was unable to confirm these transactions by any other means. As a result, I was not able to determine the accuracy, completeness and existence of the corresponding provision for leave balance of R17.6 million as disclosed in note 13 to the financial statements.

Qualified Opinion

16. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the consolidated and separate financial position of the O.R. Tambo District Municipality as at 30 June 2010 and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended, in accordance with the GRAP reporting framework and in the manner required by the MFMA.

Emphasis of matters

17. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Significant uncertainties

18. As disclosed in note 38 to the financial statements, the municipality is being sued in a number of cases, including the cancellation of contracts and failure to honour the terms of contracts. The municipality is opposing the claims, as it believes that there are reasonable grounds for cancellation of the contracts. The ultimate outcome of the matter cannot be determined, and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

19. As disclosed in note 42 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of an error discovered during the current year's audit in the financial statements of the O.R Tambo District Municipality at, and for the year ended 30 June 2009.

Irregular expenditure

20. As disclosed in note 43.2 to the financial statements, irregular expenditure to the amount of R98.9 million was incurred due to Supply Chain Management policies and procedures that were not adhered to.

Unauthorised expenditure

21. As disclosed in note 43.3 to the financial statements, unauthorised expenditure to the amount of R52.7 million was incurred as actual expenditure exceeded the budgeted amounts for which approval was not obtained, of which R35.6 million related to bulk purchases.

Fruitless and wasteful expenditure

22. As disclosed in note 43.1 to the financial statements, fruitless and wasteful expenditure to the amount of R8.6 million was incurred due to interest and penalties incurred on overdue amounts owed by the municipality.

Material losses

23. As disclosed in the consolidated statement of financial performance, the municipality impaired its debtors by an amount of R37.5 million (2009: R70.6 million) due to poor collection practices.
24. Included in note 44 to the financial statements, the municipality incurred water distribution losses of R15 million (2009: R27.8 million) as a result of inadequate controls over the distribution of water to consumers, as well as a lack of monitoring of losses incurred in the distribution of water.

Material underspending of the budget

25. As disclosed in note 45 to the financial statements, the municipality has materially underspent its budget by R163.6 million for which no satisfactory explanation was provided. This underspending relates to transfers for infrastructure and service delivery.

Additional matter

26. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

27. The supplementary appendices B – G set out on pages xx to xx do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

28. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, Municipal Systems Act of South Africa (Act No. 32 of 2000) (MSA), Division of Revenue Act of South Africa (Act No 12 of 2009) (DoRA) the Municipal Supply Chain Management Regulations of South Africa (GNR 868 of 30 May 2005) (SCM regulations), the Water Services Act of South Africa (Act No 108 of 1997) (WSA) and financial management (internal control).

Predetermined objectives

29. Material findings on the report on predetermined objectives, as set out on pages xx to xx, are reported below:

Non-compliance with regulatory and reporting requirements

30. Section 25(4) of the Municipal Systems Act has not been complied with as notice of the adoption of the Integrated Development Plan (IDP) and copies thereof were not made available to the public.

Usefulness of reported performance information

The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit finding relates to the above criteria:

31. For the selected targets, 25% of the planned indicators and targets specified in the integrated development plan and service delivery budget implementation plan for the year under review were not reported in the annual performance report.

Reliability of reported performance information

The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
- **Completeness:** All actual results and events that should have been recorded have been included in the reported performance information.

The following audit finding relate to the above criteria:

Of the overall reported targets 22% were not accurate or complete on the basis of the source information or evidence provided to support the reported targets.

Compliance with laws and regulations

Municipal Finance Management Act of South Africa, No 56 of 2003 (MFMA)

Expenditure was not paid within the parameters set by the applicable legislation

32. Section 65(2)(e) of the MFMA has not been complied with as amounts totalling R44.3 million were identified where payments were not made to suppliers within 30 days of receipt of the invoice.
33. The municipality did not comply with section 15 of the MFMA as the municipality incurred expenditure of R52.7 million which was in excess of budgeted expenditure on certain votes and for which approval was not obtained.

Accounting officer did not adhere to his statutory responsibilities

34. Section 8(5) of the MFMA has not been complied with as the Municipality's primary bank account details were not submitted to the National Treasury.
35. Section 71(1) of the MFMA has not been complied with as the municipality did not submit signed returns on their conditional grant spending for the year ended 30 June 2010 to the provincial treasury.
36. Section 69(3) of the MFMA has not been complied with as the municipal manager did not submit the service delivery and budget implementation plan and performance agreements to the Mayor within 14 days of the approval of the annual budget.
37. Proper record keeping and management was not in place resulting in requested information not being available or supplied without a significant delay as required by section 62(1)(b) of the MFMA.

The financial statements were not prepared in accordance with applicable legislation

38. The financial statements submitted for audit did not comply with section 122(3) of the MFMA. Material misstatements were identified during the audit, certain of these were corrected by management and those that were not are included in the basis for qualified opinion paragraphs.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure

39. Section 29(5) of the Municipal Supply Chain Management (SCM) Regulations has not been complied with as tenders other than those recommended in the normal course of implementing the SCM policy were awarded. In addition, the accounting officer did not notify in writing the Auditor-General, the relevant provincial treasury and the National Treasury of the reasons for deviating from such recommendation as required by section 114(1) of the MFMA.
40. Section 21 of the Municipal Supply Chain Management Regulations has not been complied with as the municipality did not obtain all the required bid documentation before the tender was issued.

Supply Chain Management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

41. Section 26(1)(a) of the Municipal Supply Chain Management Regulations has not been complied with as the municipality does not have a functioning bid specification committee.

Division of Revenue Act of South Africa, No 12 of 2009 (DoRA)**Accounting officer did not adhere to the reporting requirements on conditional allocations**

42. Contrary to section 12 of DoRA, the municipality did not submit the performance evaluation to the national transferring officer within two months after year end.
43. Contrary to section 12 of DoRA, the receiving officer of the municipality did not submit a quarterly performance report, within 30 days after the end of each quarter.

Municipal Systems Act of South Africa, No 32 of 2000 (MSA)**Accounting officer did not adhere to his statutory responsibilities**

44. The performance contracts of Section 57 managers are not entered into within 1 month of the beginning of the financial year. This is a breach of section 57 of the Municipal Systems Act.

45. Management must take all reasonable steps to ensure that the municipality has and implements a credit control and debt collection policy. The municipality has not complied with section 96 (b) of the Municipal Systems Act as it did not perform credit worthiness assessments for all new customers.
46. Section 97(1)(c) of the Municipal Systems Act states that a credit control policy and debt collection policy must provide for provision for indigent debtors that is consistent with its rates and tariff policies and any national policy on indigents. This has not been complied with as the policy was not followed.
47. Annual declarations of interest were not made by the Mayor as required by schedule 1(5) of the Municipal Systems Act.

Water Services Act of South Africa, No 108 of 1997

Accounting officer did not adhere to his statutory responsibilities

48. Section 18(1) and (2) of the Water Services Act has not been complied with as the municipality did not report on the implementation of its development plan during each financial year. The report is required to be made within four months after the end of each financial year.

INTERNAL CONTROL

49. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the acts as indicated above, but not for the purpose of expressing an opinion on the effectiveness of internal control.
50. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

51. The leadership did not ensure that the municipality had adequate controls and processes in place that was conducive to a strong control environment, and to ensure compliance with all applicable legislation. Further, there is inadequate oversight by senior officials to ensure that policies, procedures and controls are implemented correctly.

Financial and performance management

52. The consolidated and separate financial statements submitted for audit were subject to numerous amendments resulting from the audit process. Weaknesses were identified in the record keeping of the municipality in that recorded transactions do not always have adequate supporting documentation.
53. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient as the municipality has no formally adopted, and tailored, system or procedure manual which sets out processes to follow, controls in place, as well as responsible officials for the preparation, collation, reporting and monitoring of performance against predetermined objectives.

Governance

54. The internal audit department did not function as intended as it did not perform all its duties as required by the internal audit plan and it did not perform follow up audits.

Auditor-General.

East London

15 December 2010



**AUDITOR - GENERAL
SOUTH AFRICA**

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